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AN OVERSIGHT IN THE THEORY OF INCIDENCE

IN studying, recently, with a class in taxation, Professor Edwin R. A. Seligman's *The Shifting and Incidence of Taxation*, the writer of this note came across the discussion of *A Uniform Tax* (on agricultural land) *according to the Quantity or the Quality of the Land*.¹ Analysis of the argument of a part of this section seems to show a rather important oversight which entirely vitiates the conclusion.

Professor Seligman's discussion of the matter here in question is as follows:

"Suppose that there are three tracts of land producing wheat of the same quality, but, as a result of differences in fertility, yielding respectively ten, twenty, and thirty bushels to the acre; and suppose further that this quality of wheat is worth 50 cents a bushel. Tract A would thus yield \$5.00 an acre, tract B, \$10.00 and tract C, \$15.00."

Then "if in the above case the tax per acre on grade A were 50 cents, on grade B, \$1.00 and on grade C, \$1.50," the price of wheat would be "55 cents per bushel" instead of 50 and "the amount of taxes paid by the landowners would exactly equal the increased price obtained from the consumers. Hence, whenever a land tax is graded as to follow with precision the differential advantages of production, and where the land is cultivated intensively *up to the point when the law of diminishing returns becomes effective*,² given a constant demand, *the tax will be shifted entirely to the consumers*,³ without causing them any additional loss."

It is not clear what Professor Seligman means regarding diminishing returns. In the strict sense of the expression, returns would begin to "diminish" on tracts C and B long before it was worth while to cultivate land as poor as tract A.

¹ See third edition, New York (The Columbia University Press), 1910, pp. 259, 260.

² Italics are the present writer's.

³ Ibid.

What should be assumed is that the better tracts are cultivated intensively up to such a point that the marginal return to labor (or labor and capital) on them is no greater than the return to labor on the extensive margin. For the remainder of the present discussion it will be presumed that this is what Professor Seligman really means. It is evidently assumed — altho it is not specifically stated — that the differences in fertility among the different tracts are natural and more or less permanent rather than that they are maintained by differences in effort and investment among the owners.

The principal point which is involved in the main criticism here advanced is the nature and significance of the intensive margin of cultivation. On Mr. Seligman's assumption regarding different grades of land, tract C yields 30 bushels to the same amount of labor which can get only 10 from tract A. But it may be entirely possible that the labor which yields 10 bushels on A could, by being used for the more intensive cultivation of C (or B), add 9.8 bushels to the product otherwise there yielded, making a total of 39.8 bushels. To assume an addition to the product on this tract, from the added labor, of anything over 10 bushels, would be inconsistent with the hypothesis that tract A is actually used. But to assume an addition of 9.8 bushels is entirely consistent with that hypothesis.

Let us turn now to the tax of fifty cents on tract A, \$1.00 on tract B and \$1.50 on tract C. Since tracts B and C are superior to tract A by more than the entire tax to which their owners are to be subjected, these tracts would continue to be used to produce wheat and to produce at least as much as if untaxed, even if there were no increase of price whatever because of the tax. It is because the owner of tract A will cease cultivating if he cannot get fifty cents more for his 10 bushels, when the tax is laid, that the tax is supposed to be shifted entirely upon the consumers in a price of wheat five cents higher per bushel than before. But if the labor which produces 10 bushels on A can, by increased intensiveness of cultivation, add 9.8 bushels to the product of C, this result clearly need not follow. For the tax, being graded upon the

land according to quality, will not be raised on tract C merely because C is now worked more intensively. That is to say, the extra 9.8 bushels produced on tract C adds nothing to the tax. Hence, the producer of this 9.8 bushels need only receive \$5.00 to induce the production¹ and not \$5.50. But \$5.00 for 9.8 bushels is little more than fifty-one cents a bushel. It follows, then, that the tax need not raise the price, as claimed by Seligman, by five cents a bushel, the amount which would reimburse the owners of all the farm land (tracts A, B, and C) for the tax, and which would be necessary to keep tract A in use, but only about one cent a bushel, the amount necessary to cover the extra cost of producing wheat on the (now) slightly lowered *intensive* margin.

The same oversight above criticized occurs near the beginning of the section here under discussion, where Professor Seligman supposes a tax of fifty cents on each acre of agricultural land without regard to quality and concludes that such a tax would raise the price (demand being constant) by five cents a bushel. No such conclusion necessarily follows.

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¹ Admission is made that such a tax, by reducing slightly the efficiency of goods production might, according to the quantity theory of money, slightly raise the general level of prices and the price of wheat with the rest. No allowance is made for this point, however, in the discussion above.